Refunding Policy

Introduction:

The purpose of this policy (the "Policy") of the County of San Diego (the "County") is to establish minimum guidelines for the County's use of current, advanced, forward and synthetic refundings. This Policy sets forth these guidelines for the Debt Advisory Committee (the "DAC") to consider when developing a recommendation that the County should pursue a refunding transaction, but does not obligate the County to proceed in every case that the minimum guidelines are met. The DAC shall have the flexibility to exercise discretion in waiving these guidelines. Additionally, the DAC may impose stricter standards for specific transactions that may pose a greater level of risk to the County. It is expected that this Policy will be reviewed periodically by the DAC.

Objectives:

The primary objective of proceeding with a refunding shall be to benefit the County by:

- Providing net present value debt service savings, and/or
- Eliminating burdensome or restrictive covenants imposed by the terms of the bonds to be refunded, and/or
- Changing the type of debt instrument, and/or
- Restructuring the County's overall debt service portfolio.

Minimum Guidelines:

The County may consider different financing structures for refunding issues that typically meet the following guidelines:

- Refunding issues should generate net present value savings *(as outlined in the next section.)*
- The final maturity of the refunding bonds should be no longer than the final maturity on the refunded bonds.
- Refunding issues should be structured to achieve level annual debt service savings.
- Refunding issues should generate a minimum of $1 million total net present value savings and $100,000 of savings on an annual basis.

Solely meeting one or more of the minimum guidelines will not necessarily result in the County executing a refunding issue. All costs and benefits of the refunding will be taken into account by the the Debt Advisory Committee (DAC) in determining if the refunding is in the best interest of the County.

Present Value Savings Calculation:

A present value analysis should be prepared to identify the economic effect of any proposed refunding. To proceed with a refunding a minimum net present value savings amount, as a percentage of the refunded par amount, shoud be achieved. Appropriate saving thresholds for the different refunding alternatives, based on the level of risk they pose to the County, are presented below. The savings shall be calculated net of all issuance fees and using a net debt service savings approach, which takes into consideration arbitrage rebate requirements .

- Current Refunding: A minimum of 3% net present value savings should generally be achieved.

- Advance Refunding: A minimum of 4% net present value savings should generally be achieved. Prudent analysis should be performed to determine the most efficient method of funding the escrow portfolio.

- Forward Refunding: A minimum of 4% net present value savings should generally be achieved.

- Synthetic Refunding: A minimum of an additional 2% net present value savings over the applicable savings levels, as outlined above, should generally be achieved. Because the level of risk will vary depending on the specific structure of the transaction and market conditions at the time of issuance, the DAC has the discretion to prescribe higher levels of target savings to optimize the County's financial objectives.

Guiding Principles:

In evaluating refunding opportunities and applying the above referenced guidelines, the DAC and staff shall also consider the following:

- For advance refundings, adjustments to the savings threshold may be justified based on the length of time before the call and the length of time from the call to maturity. The longer the escrow, the higher the savings threshold should be. Conversely, shorter escrows may justify a lower savings threshold.

- For advance refundings with very short escrows, the County should consider a forward refunding to preserve the ability to advance refund the bonds at a future date.

- The couponing and/or callability of the refunding bonds may also justify adjustments to the savings threshold. Non-callable refunding bonds, for example, might justify a higher threshold.

- For advance refundings, adjustments to savings thresholds may be justified based on where interest rates are at the time of the refunding relative to historical markets. In low interest rate markets a lower threshold may be justified while a higher threshold would be justified in high interest rate markets.

Definitions:

Advance Refunding- Refunding bonds issued more than 90 days before the call date of the bonds being refunded. A bond issue may be advance refunded only once.

Aggregate Present Value Savings- The Present Value Savings in each year added together.

Current Refunding- Refunding bonds issued less than 90 days before the call date of the bonds being refunded.

Forward Refunding- A refunding in which the bonds are sold with the intent to close or deliver at some future point in time, generally more than 30 days after pricing, and often to coincide with a date 90 days prior to the call date on the refunded bonds, thereby qualifying as a Current Refunding.

Net Debt Service Savings Approach- A method to calculate refunding savings that accounts for the difference in interest earnings of the debt service reserve funds of the refunded and refunding bonds.

Net Present Value Savings- A method of calculating the aggregate amount of savings on a refunding transaction net of all issuance fees.

Present Value Savings- In each semi-annual period, the present value of the debt service on the refunding bonds is subtracted from the present value of the debt service on the refunded bonds using the arbitrage yield on the refunding bonds as the discount rate.

Synthetic Refunding- Includes more complex, alternative refunding instruments such as interest rates swaps, derivatives, and hedges (including interest rate swaptions, caps, floors, and collars).